



LAC-IEE-08-71

ENVIRONMENTAL THRESHOLD DECISION

Activity Location: Paraguay

Activity Title: Economic Growth – Private Sector Competitiveness, **Development Credit Authority (DCA) – *Banco Regional Financiera El Comercio* Activity**

Activity Number: 526-010

Life-of-Activity Funding: \$300,000

Life-of-Activity: FY 2008 – FY 2014

IEE prepared by: Fernando Balsevich, Activity Manager

Reference ETDs: LAC-IEE-07-06, LAC-IEE-02-04

Recommended Threshold Decision: Categorical Exclusion, Negative Determination with Conditions

Bureau Threshold Decision: Concur with Recommendation

Comments:

This Threshold Decision amends LAC-IEE-02-04 and LAC-IE-07-06 to include the DCA – Banco Regional Financiera El Comercio activity through FY 2014

A **Categorical Exclusion** is issued the DCA - *Banco Regional Financiera El Comercio* Activity for the support of intermediate credit institutions, pursuant to CFR 216.2(c)(2):

(x) Support for intermediate credit institutions when the objective is to assist in the capitalization of the institution or a part thereof and when such support does

not involve the reservation to right and approve individual loans made by the institution.

A **Negative Determination with Conditions** is issued to the DCA - *Banco Regional Financiera El Comercio* Activity for USAID-backed private loans that are made to businesses whereby significant negative environmental effects are not foreseen. The condition is:

Conditions also include:

Responsibilities

- Each activity manager or **Cognizant Technical Officer (CTO)** is responsible for making sure environmental conditions are met (ADS 204.3.4). In addition, CTOs are responsible for ensuring that appropriate environmental guidelines are followed, mitigation measures in the IEE are funded and implemented, and that adequate monitoring and evaluation protocols are in place to ensure implementation of mitigation measures.
- It is the responsibility of the **Strategic Objective (SO) Team** to ensure that environmental compliance language from the ETD is added to procurement and obligating documents, such as activity-related Strategic Objective Grant Agreements (SOAGs) and Modified Acquisition and Assistance Request Documents (MAARDs).
- The **Mission Environmental Officer** will conduct spot checks to ensure that conditions in the IEE and this ETD are met. These evaluations will review whether guidelines are properly used to implement activities under this ETD in an environmentally sound and sustainable manner according to USAID and applicable U.S. Government policies and regulations.
- The implementing **contractor or partner** will ensure that all activities conducted under this instrument comply with this ETD. Also, through its regular reporting requirements, a section on environmental compliance (e.g. mitigation monitoring results) will be included.

Amendments

- Amendments to Initial Environmental Examinations (IEE) shall be submitted for LAC Bureau Environmental Officer (BEO) approval for any activities not specifically covered in the IEE, which include:
 - Funding level increase beyond ETD amount,
 - Time period extension beyond ETD dates (even for no cost extension), or

- A change in the scope of work, such as the use of pesticides or activities subject to Foreign Assistance Act sections 118 and 119 (e.g. procurement of logging equipment), among others.
- Amendments to IEEs include Environmental Assessments (EA or PEA) and approval of these documents by the LAC BEO could require an annual evaluation for environmental compliance.

Victor H. Bullen Date 09-24-2008

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Copy to: John Beed, USAID/Paraguay Mission Director
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Attachments:

- Amended Initial Environmental Examination,

File: P:\LAC.RSD.PUB\RSDPUB\EES\Reg 216\IEE\IEE08\LAC-IEE-08-71 ETD (PA – Economic Growth, DCA Banco El Comercio, amend IEE-02-04, IEE-07-06).doc

Recommendation for Threshold Decision:

Loans will not be granted for activities likely to harm the natural environment, as defined in the Development Credit Authority Article II.

John Beed
USAID/Paraguay Mission Director

UKurth. MEO:

Bruce Bayle, REA

Activity Description

USAID/Paraguay proposes to implement a Development Credit Authority (DCA) transaction to support a Loan Portfolio Guarantee (LPG) with two regulated financial intermediaries: (1) Banco Regional, 2) Financiera El Comercio. USAID will share a maximum risk of 50% of the loan in case of default. The loan portfolio guarantee will encourage financial intermediaries to extend credit to Paraguayan micro, small, and medium-sized enterprises (MSMEs) in the agricultural sector. USAID will rely on lenders to exercise due diligence in approving and monitoring the loans guaranteed under this DCA, and will not approve individual loans.

The LPG will cover a pool of new loans from these two financial institutions to multiple borrowers utilizing a value-chain approach in the agriculture sector.

The guarantee is designed to encourage the growth of MSMEs in the agriculture value chain, especially in the clusters receiving technical assistance through the Paraguay Vende Program. The DCA activity is intended to provide critical support for the advancement of USAID/Paraguay's strategic objective "Economic Growth – Private Sector Competitiveness." In particular, the DCA activity will have a direct impact on the achievements of the Economic Growth Program Area through the sub-element focus on supporting Sector Supply and Value Chains.

USAID/Paraguay proposes that Banco Regional will allocate \$3.5 million and Financiera El Comercio will allocate \$1.6 million in loans with guarantee capacity. The DCA will be utilized for a six year period to leverage commercial financing for private Paraguayan micro, small, and medium-sized enterprises (MSMEs) in the agricultural sector. A MSME is defined as a business with no more than 100 employees. Qualifying loans cannot be greater than \$200,000 and are expected to have an average size of \$150,000 or less. In addition, the loans will have a minimum two year time frame to ensure that the loans are not being used for working capital/current expenditures, but instead for investment in equipment or operations.

Complementary Technical Assistance: To help propel the country forward after the 1998-2002 recessions, USAID/Paraguay launched the Paraguay Vende I Program in November 2003 to create more jobs in the country's interior as a means to reduce poverty. At that time, the conditions were ripe for expanding national and international trade; although despite these conditions, there was very little foreign trade and low economic growth. Products from the country's interior did not make it to cities or MERCOSUR markets. Likewise, investments decreased, many production facilities and land parcels were unproductive, and interior cities did not benefit from new roads.

The Paraguay Vende Program was designed to promote business growth and development via promising economic corridors. Providing market-based technical assistance to companies and producers, Paraguay Vende aims to increase sales, create new jobs, and generate increased investment. The project provides technical assistance aiming to produce what is sold in the market rather than selling what is

produced. Within this context, the technical assistance focuses on working with firms and producers in order to find buyers, contacting and organizing small producers, and identifying local and international markets. Paraguay Vende provides cost-free assistance; nevertheless, companies and producers receiving such assistance also provide counterpart allocation in the form of human resources and materials to achieve a successful technical intervention.

Paraguay Vende provides its technical assistance in three economic corridors selected on the basis of incorporating areas with both economic potential and extreme poverty. The strategy of the economic corridors takes into consideration existing road connections, tying to connect poorer rural areas with secondary cities, and finally linkages with larger cities. Paraguay Vende maintains Economic Services Centers for the Eastern Corridor (based in Ciudad del Este), the Southern Corridor (Based in Encarnación) and the Center Corridor (Based in Coronel Oviedo). These Economic Service Centers provide technical assistance, market information, and other business services to small and medium enterprises in some of Paraguay's poorest departments.

Over its life, the Paraguay Vende Program has identified credit constraints in the agricultural value chains of its beneficiaries. Resolving the financial bottlenecks means significant opportunities to generate economic growth in rural areas where hundreds of small and commercial farmers live. Historically, the Paraguay Vende Program has been successful in helping its beneficiaries to access credit and the results were significant. However, constraints remain in areas where cash flow opportunities for growth exist but credit access is difficult due to lack of collateral and sector/project risks. Moreover, Banco Regional has expressed their willingness to work with the Paraguay Vende Program and has recognized that their risk is reduced when they lend to a project that receives technical assistance from the Paraguay Vende Program.

Illustrative Activities and Final Borrowers of the DCA Program: USAID intends to support a financial guarantee which will help small producers to increase productivity by improving value chain efficiencies and promoting more forward and backward linkages.

Borrower Sector: The borrowers under this guarantee will be Paraguayan micro, small and medium enterprises (MSMEs) in the agriculture sector, including companies along the entire agriculture value chain, from farmer to exporter. MSMEs are defined as businesses with no more than 100 employees. In addition, all borrowers shall be either (i) microenterprises or (ii) businesses in a supply chain that includes microenterprises. Loans must have a minimum two year time period to encourage investment-tenor lending. Given Paraguay Vende's pre-existing relationship with Banco Regional, it is expected that the bank will focus primarily on the sectors supported by Paraguay Vende, including sesame, bananas, organic sugar cane, carrots and flour production. There is an especially large demand for credit (and potential for growth) in the biofuel and chicken and pork livestock sectors.

Underserved Value Chains: Despite the rapid growth of deposits in recent years, the availability of long-term credit is limited by the short terms of most bank deposits and

the poor credit quality of most potential borrowers. The government has tried to address the issue of short deposit terms by introducing differential reserve requirements, with higher levels of reserves required on short-term deposits. The Central Bank pays interest on a portion of these reserve requirements. However, this measure has so far failed to produce the expected effects, as the level of bank deposits in local currency that are current accounts decreased only slightly from 82% of the total in December 2004 to 80% of the total in December 2007. In fact, the availability of credit extended by commercial banks to the private sector contracted by one-quarter in 2003, but recovered again in 2006-07.

The high level of bad debts used to be an obstacle to expanding credit, but it has improved in recent years. Past due loans as a percentage of the banks' total loan portfolio for the banking sector as a whole (excluding the troubled state-owned Banco Nacional de Fomento) fell to only 1% in December 2007, down from 10.4% in December 2004 and 14.5% at end-2002.

Credit in the agricultural sector has been exceedingly difficult for small-scale farmers to gain access to. Seventy percent of farmers with fewer than 20 hectares of land are unable to obtain credit. Of those who are able to access credit, 16% receive it from the formal public sector, 8% from cooperatives and producers' organizations, and 72% from the informal sector of middlemen, wholesalers, factories and truckers. (World Bank, 2007, Report No: 4 14 19-PY)

A new second-tier state bank, the Agencia Financiera de Desarrollo (AFD), began operations in 2006 to channel soft loan finance from international financial institutions to local banks and other financial organizations. In its second year of operation, the AFD approved loans totaling \$60 million in 2007, of which \$26 million went to the cattle-ranching sector, \$21million to farming and \$6 million to transport companies. The average loan term was 9.8 years and the average interest rate was 12.5%. While the creation of the AFD is a good start, more assistance is needed to mobilize long-term credit.

Facilitate greater access to credit by enterprises within the agriculture/agro-industry value chains, which lack sufficient access to credit and are relatively unknown to banks due to lack of familiarity and elevated perceptions of risk. Beyond promoting changes in financial institution and sector behavior, the proposed DCAs LPG will also assist in the growth and development of targeted value chains, which will promote economic growth and trade as well as promoting natural resource management.

Small Enterprises: While still promoting the diversification of microfinance lending, which has grown substantially over the years, partially due to USAID/Paraguay efforts, the DCA LPG will facilitate greater access to long-term credit for small enterprises, which appear to fall within a gap in the Paraguayan financial sector.

Environmental Impact and Mitigation Measures:

Criteria for qualifying loans, for this and all DCA programs, are attached as Annex A. “Activities which are likely to have a significant adverse effect on the environment” require explicit approval of USAID, including specific cases such as pesticides, logging, and conversion of natural habitat to agriculture. USAID/Paraguay will not approve such activities under this program.

Internal Monitoring and Reporting:

The CTO will receive semi-annual reports from each participating financial institution certifying that all loans covered by the guarantee activity fall within the DCA eligibility guidelines as “qualifying loans”. Any loan found to be for non-qualifying purposes will be excluded from DCA guarantee coverage.

The CTO and/or MEO will visit a limited number of loan activities to verify compliance.

Recommendations:

Based on the above narrative, USAID/Paraguay recommends:

Categorical Exclusion: Under 22 CFR 216.2(c)(2)(x), DCA activities are subject to a categorical exclusion when,

“Support for intermediate credit institutions when the objective is to assist in the capitalization of the institution or a part thereof and when such support does not involve the reservation to right and approve individual loans made by the institution.”

Negative Determination with Conditions to assure that the USAID-backed private loans are made to businesses whereby significant negative environmental effects are not foreseen. The “condition” is compliance with the attached “Section 2.02. - Criteria for a Qualifying Loan”. The MEO and CTO will verify compliance with this condition.

ATTACHMENT A

**DEVELOPMENT CREDIT AUTHORITY AGREEMENT
ARTICLE II**

Qualifying Loans

Section 2.01. **Guarantee Coverage.** No Loan shall be covered by the terms of the Agreement nor placed under the coverage of the Agreement by the Guaranteed Party unless such Loan is a Qualifying Loan.

Section 2.02. **Criteria for a Qualifying Loan.** A Qualifying Loan is a Loan made by the Guaranteed Party that meets the criteria in the Guarantee Term Sheet (Attachment 1, above) and that satisfies all of the following criteria:

- a) The Loan must not be used to finance any of the following:
 - (1) Goods or services which are to be used primarily to meet military requirements or to support police or other law enforcement activities,
 - (2) Surveillance equipment,
 - (3) Equipment, research and/or services related to involuntary sterilization or the performance of abortion as a method of family planning,
 - (4) Gambling equipment, supplies for gambling facilities or any hotels, casinos or accommodations in which gambling facilities are or are planned to be located, or
 - (5) Activities which significantly degrade national parks or similar protected areas or introduce exotic plants or animals into such areas.
 - (6) Loans related to the purchase of Genetically Modified Organism seeds not approved by the Paraguayan Comision de Bioseguridad or successor Government of Paraguay agency with the same or substantially similar regulatory functions.

(b) The Loan must not be used to finance any of the following without the prior written approval of USAID:

- (1) Pharmaceuticals,
- (2) Pesticides,

- (3) Logging equipment,
- (4) Luxury goods (including alcoholic beverages and jewelry),
- (5) Establishing or expanding any enterprise that will export raw materials that are likely to be in surplus in world markets at the time such production becomes effective and that are likely to cause substantial injury to U.S. producers,
- (6) Tobacco or agribusiness activities contributing to tobacco production, promotion or use,
- (7) Activities which would result in the loss of forest lands due to livestock rearing, road construction or maintenance, colonization of forest lands or construction of dams or other water control structures,
- (8) Activities which are likely to have a significant adverse effect on the environment, including any of the following (to the extent such activities are likely to have a significant adverse impact on the environment):
 - (a) programs of river basin development,
 - (b) significant irrigation or water management projects (including dams and impoundments),
 - (c) agricultural land leveling,
 - (d) major drainage projects,
 - (e) large scale agricultural mechanization,
 - (f) new lands development,
 - (g) resettlement projects,
 - (h) penetration road building or road improvement projects,
 - (i) construction of powerplants or industrial plants, or
 - (j) large scale potable water and sewerage projects,
- (9) Activities which the Guaranteed Party is aware are reasonably likely to contribute to the violation of internationally recognized rights of workers.

Approval of loans to finance activities described in subsections (2), (3), (7) or (8) above will be contingent upon the submission by the Guaranteed Party of evidence sufficient to demonstrate compliance with local environmental laws and to enable USAID to make an assessment of the environmental impact of such activities.

(c) The Loan must be made at interest rates and on terms consistent with those generally prevailing among private commercial lenders in the borrower's country.

(d) The Loan must be funded from the Guaranteed Party's capital or funds acquired by the Guaranteed Party on a market basis, and not from subsidized loan capital received from government sources, international agencies or not-for-profit institutions. Any loans or other forms of financing that the Guaranteed Party receives through the U.S. Overseas Private Investment Corporation (OPIC) shall not be eligible as a Qualifying Loan. Further, the Guaranteed Party shall not use any OPIC guaranteed funds for Qualifying Loans.

(e) The Loan must have a scheduled maturity date for the entire principal amount no later than the Final Qualifying Loan Maturity Date.

(f) Except as otherwise agreed by USAID, the Loan must not be made in connection with the refinancing, repayment or repurchase of an existing loan.

(g) The Loan must have been placed under coverage of the Agreement in compliance with Article III.